

Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 EA-07 IO-13 ISO-00 CIAE-00 DODE-00

PM-04 H-02 INR-07 L-03 NSAE-00 NSC-05 PA-01 PRS-01

SP-02 SS-15 USIA-06 AID-05 COME-00 FRB-03 TRSE-00

XMB-02 OPIC-03 CIEP-01 LAB-04 SIL-01 OMB-01 CEA-01

STR-04 AGR-05 AGRE-00 /116 W
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P R 201727Z SEP 76

FM AMEMBASSY BONN

TO SECSTATE WASHDC PRIORITY 1983

INFO AMEMBASSY LONDON

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DEPARTMENT PASS TREASURY, FRB AND CEA

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E.O. 11652: N/A

TAGS: EFIN, GW
SUBJECT: INFLATION UPDATE

REF.: BONN 12330

1. SINCE WE LAST REPORTED IN DETAIL ON INFLATION ABOUT TWO MONTHS AGO, THERE HAS BEEN A TREND CHANGE TOWARD DECELERATION IN THE RATE OF INCREASE IN CONSUMER PRICES. FROM JANUARY'S 3 PERCENT TO JUNE'S 6 PERCENT RATE, A CLEAR ACCELERATION WAS TO BE NOTED. (THE MEASUREMENT CONCEPT USED HERE AND THROUGHOUT THIS CABLE IS THE SEASONALLY ADJUSTED ANNUAL RATE OF INCREASE IN THE THREE MONTH RUNNING AVERAGE OF THE INDEX.) HOWEVER, THE JULY RATE SLOWED TO 4.8 PERCENT AND IN AUGUST IT MODERATED STILL FARTHER TO 4.0 PERCENT. HOWEVER, GIVEN EXPECTED DEVELOPMENTS IN FOOD AND RAW MATERIALS PRICES AS WELL AS WAGES, EXPLAINED BELOW, WE ANTICIPATE THAT THE RATE OF PRICE INCREASES IS BOUND TO PICK UP AGAIN SOMEWHAT BEFORE VERY LONG.

2. AN IMPORTANT FACTOR IN THE RECENT MODERATING OF INFLATION HAS BEEN THE BEHAVIOR OF FOOD AND AGRICULTURAL PRICES. THE FOOD COMPONENT OF THE CPI WAS RUNNING AT 11.5 PERCENT (S.A.A.R., 3 MONTH RUNNING AVERAGE) IN APRIL; BY JULY IT WAS DOWN TO 2.4 PERCENT. UNDERLYING THIS WAS THE SHARP SLOW DOWN IN THE INFLATION OF AGRICULTURAL PRODUCT PRICES PER SE THAT TOOK PLACE OVER THE SAME TIME PERIOD; THE RATES OF INCREASE IN THE EARLY PART OF THE YEAR WERE IN THE PLUS 20-30 PERCENT RANGE, BUT BY JULY HAD REGISTERED A 12.5 PERCENT DECLINE. (MEAT AND POTATOES PRICES WERE LEADERS IN THE PRICE FALL.) THIS IS LIKELY TO BE A TEMPORARY PHENOMENON AS DROUGHT-INDUCED SHORTAGES AND OTHER FACTORS ARE EXPECTED SOON TO PUSH AGRICULTURAL PRICES UP AGAIN.

4. A SOMEWHAT DIFFERENT PATTERN HAS BEEN OBSERVED IN INDUSTRIAL PRICES. THESE HAVE TRENDED STEADILY UPWARD SINCE THE 2 PERCENT RATE AT THE BEGINNING OF THE YEAR TO 7.5 PERCENT CURRENTLY. CONTRARY TO THE GENERAL IMPRESSION, THIS DEVELOPMENT HAS NOT BEEN ATTRIBUTABLE TO LIMITED OFFICIAL USE

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RISING PRICES FOR IMPORTS IN GENERAL, OR RAW MATERIALS IN PARTICULAR. IT IS ONLY IN JULY, THE LAST MONTH FOR WHICH SEASONALLY ADJUSTED DATA IS AVAILABLE, THAT IMPORT PRICES, PARTICULARLY FOR RAW MATERIALS, HAVE RISEN MARKEDLY; BEFORE THAT THEY TENDED TO BE A CALMING FORCE ON INFLATIONARY DEVELOPMENTS, AS MAY BE SEEN IN THE ACCOMPANYING TABLES. THE AUGUST UNADJUSTED DATA SUGGESTS THAT THE VERY RECENT UPWARD MOVEMENT IN IMPORT

PRICES IS CONTINUING AND THAT IT WILL INCREASINGLY BE AN INFLATIONARY PRESSURE RATHER THAN THE MODERATING INFLUENCE WHICH IT HAS BEEN OVER THE FIRST HALF OF THE YEAR (UNLESS THE DM CONTINUES TO APPRECIATE CONSIDERABLY), THE BUNDESBANK DOES NOT EXPECT THAT THE STRENGTHENING OF THE DM SO FAR WILL BE SUFFICIENT TO OFFSET THIS TENDENCY TO HIGHER IMPORT COSTS.

5. DURING 1976'S FIRST HALF WAGES HAVE BEEN A RELATIVELY BENIGN FACTOR, CONTRIBUTING VERY LITTLE TO THE UPWARD TREND IN PRICES, INDUSTRIAL, OR OTHERWISE. THE NEUTRAL EFFECT OF WAGES IN THE FORMATION OF PRICE PRESSURES DOES NOT SEEM LIKELY TO BE REPEATED IN THE SECOND HALF, AS EVIDENCED BY THE JULY DATA AND THE STRONG POSSIBILITY OF POST-ELECTION "CATCH UP" RENEGOTIATIONS, NOR INTO 1977. IT WAS ON THIS POINT THAT RECENT DIFFER-

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P R 201727Z SEP 76

FM AMEMBASSY BONN

TO SECSTATE WASHDC PRIORITY 1984

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ENCES DEVELOPED BETWEEN THE BUNDESBANK AND THE ECONOMICS MINISTRY. BANK PRESIDENT KARL KLASSEN THOUGHT THE MINISTRY NOT SUFFICIENTLY AMBITIOUS IN ITS IMPLIED FORECAST OF 1977 PRICE DEVELOPMENTS CONTAINED IN A TAX REVENUE ESTIMATING EXERCISE (SEE BONN 14965). HE FELT THAT A LESS-THAN-FOUR PERCENT PRIVATE CONSUMPTION DEFATOR SHOULD HAVE BEEN USED, WHILE THE MINISTRY SAW 4.5 TO 5 PERCENT AS THE RANGE FOR THIS MEASURE OF INFLATION. UNDERLYING THE ISSUE WERE THE DIFFERING ASSUMPTIONS REGARDING NEGOTIATED WAGE INCREASES. WE UNDERSTAND THE BUNDESBANK PUSHED FOR A 7 PERCENT ASSUMPTION, WHILE THE ECONOMICS MINISTRY'S IMPLICIT WAGE HIKE FORECAST WAS 8 PERCENT. BOTH OF THESE CONTRAST WITH THIS YEAR'S 5-6 PERCENT RANGE OF SETTLEMENTS, AND WITH OUTSIDE OPINIONS THAT 10 PERCENT WOULD BE CLOSER TO NEXT YEAR'S PROBABLE SETTLEMENT RATE. THE BIG WORRY OF BOTH THE GOVERNMENT AND BANK UNDERLYING THIS WHOLE AFFAIR WAS THE SIGNAL THEY WOULD BE SENDING RE EXPECTATIONS FOR THE INTER-RELATED WAGE AND INFLATION DEVELOPMENTS IN 1977. FOR THAT REASON BOTH WERE EMPHASIZING THE LOW-SIDE OF THE RANGE OF WHAT MIGHT HAPPEN NEXT YEAR AND INDULGING IN WISHFUL THINKING MORE THAN REALISTIC FORECASTING, PERHAPS HOPING FOR A LITTLE SELF-FULFILLING PROPHECY EFFECT.

6. PERTINENT TABULAR INFORMATION DERIVED FROM INDEX NUMBERS IN THE BUNDESBANK'S REIHE 4 SERIES WHICH RELATE TO THE ABOVE ANALYSIS FOLLOWS:

TABLE I

PERCENT INCREASE THREE MONTH RUNNING AVERAGE (1)
SEASONALLY ADJUSTED PRICE INDICES - ANNUAL RATES

	CONSUMER	FOOD PRICES	AGRICULTURAL
1976	PRICES	(COMPONENT OF CPI)	PRICES

JAN	3.1	2.7	20.1
FEB	3.3	5.2	25.2

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MAR	3.9	9.4	31.4
APR	5.0	11.5	28.9
MAY	5.6	7.9	17.1
JUNE	6.0	3.7	1'8
JULY	4.8	2.4	-12.5
AUG	4.0		

(1) COMPARISON OF THREE MONTH PERIOD ENDING IN MONTH
STATED WITH PREVIOUS THREE MONTH PERIOD.

TABLE II

PERCENT INCREASE THREE MONTH RUNNING AVERAGE (1)
SEASONALLY ADJUSTED PRICE INDICES - ANNUAL RATES

	INDUSTRIAL	IMPORT	IMPORTED RAW MATERIALS
1976	PRICES	PRICES	(NON-AGRICULTURAL)

JAN	2.1	6.2	11.3
FEB	2.1	4.3	-1.8

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MAR	2.5	-6.1	-16.7
APR	4.0	-8.8	-14.4
MAY	5.3	-9.6	-7.3
JUNE	7.2	2.5	2.4
JULY	7.4	11.3	21.1

(1) COMPARISON OF 3 MONTH PERIOD ENDING IN MONTH STATED

WITH PREVIOUS THREE MONTH PERIOD.

TABLE III

SEASONALLY ADJUSTED GROSS INDUSTRIAL WAGES (PER HOUR)(1)

1976	PERCENT INCREASE
----	-----
JAN	9.7
FEB	2.2
MAR	-2.2
APR	-0.7
MAY	6.6
JUNE	14.7

(1) COMPARISON OF 3 MONTH PERIOD ENDING IN MONT STATED
WITH PREVIOUS THREE MONTH PERIOD.
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